# Private credit funds retune strategy as acquisition financing set to open up for banks

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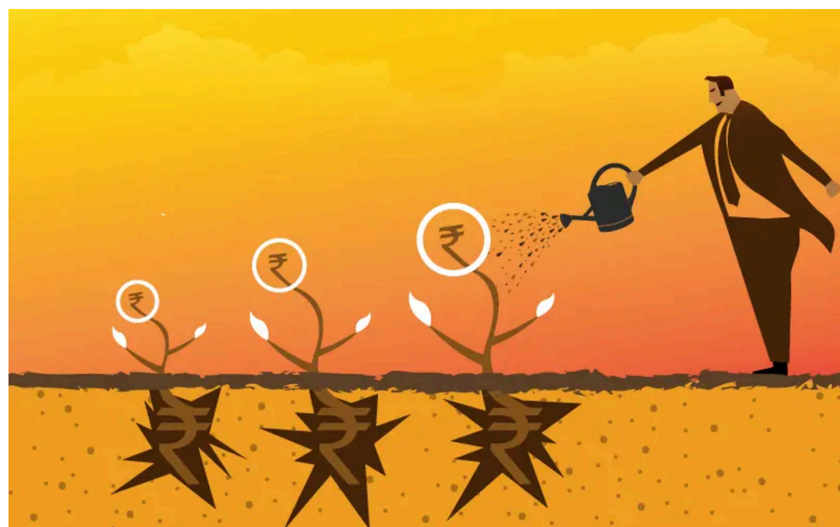

Credit: Akshansh Mann/VCCircle

With the Reserve Bank of India's mandate allowing banks to finance strategic acquisitions coming into effect from July 1, the private credit industry is expecting competition to set in for large-value acquisitions and returns generated to come under pressure.

In February, the central bank amended the credit-facilities regulations (Commercial Banks – Credit Facilities Directions, 2025 and the Commercial Banks – Concentration Risk Management Directions, 2025) permitting banks to finance acquisition of shares or compulsorily convertible debentures (CCDs) of a target entity or the target's holding company to secure long-term strategic 'control'.

Private-credit fund representatives VCCircle spoke to said that the banks may largely target straightforward acquisitions of large value, where their lower cost of capital will be an advantage, and that private funds will focus on the larger market of more complex transactions.

"The RBI's move will certainly make bank capital more competitive for larger, straight forward transactions, especially where the borrower is investment grade and the deal structure is clean," Eshwar Karra, Deputy Managing Director, Kotak Alternate Asset Managers said.

Private credit firms typically charge a spread differential of 300 to 500 basis points (3% to 5%) over traditional banking rates, for acquisition financing.

“In that sense, some plain vanilla acquisition financing that earlier went to private credit could move back to banks given their lower cost of funds,” he added.

Additionally, since the framework permits banks to refinance existing acquisition debt and to refinance the target’s existing debt where such refinancing is integral to the acquisition, it creates a back-book risk for private credit funds.

A "back-book risk" in private credit refers to the danger of existing loan portfolios losing value or defaulting. Typically, private credit funds rely heavily on short-term loans from commercial banks where the funds use their existing portfolio of loans as collateral. If portfolio companies begin to default, banks can aggressively mark down the collateral value.

“Deals originally underwritten at 13 to 18% IRRs can be taken out by bank refinancing once the target stabilises, compressing realised IRRs below underwritten levels. The impacts the duration and yield realisation of existing portfolios,” Ameya Khandge, Partner - Banking and Finance, Trilegal said.

**Larger market left to private funds**

But, all things considered, banks will be able to operate only in a small segment of the market.

Pure acquisition financing, particularly the strategic control acquisitions that the new RBI framework targets, possibly represents 15 to 25% of the overall market, according to experts. The regulatory norms have strict norms on eligibility, leverage and control structures, and hence, a sizeable portion of the market will rely on private credit, especially for more complex deals.

“The current regulation has many restrictions, such as listing requirements and pure-play acquisitions. New capex funding is not being covered, and neither are unlisted companies, which comprise the majority of the market,” Siddhartha Choudhury, Senior Portfolio Manager, Vivriti Asset Management said, adding that while deal flow may be marginally impacted, the long-term impact of the norms on private credit firms will be limited.

“We don't feel that banks being allowed to do acquisition financing seriously restricts the space for private credit funds,” Choudhury added.

For instance, private credit firms will continue to do sponsor-led and structured situations deals; mergers and acquisitions by non-bank lenders and financial services entities which are outside the RBI's framework; and deals such as promoter share-pledge financing, holding company leverage, and acquisitions led by foreign owned or controlled companies.

Special situations, pre-IBC deals and stressed-but-solvent transactions will also stay with private credit because bank credit committees, particularly at state-owned banks, are unlikely to lean into these even within the new framework, according to industry experts.

Trilegal's Khandge too lists the market segments private credit funds would tap under the changed circumstances.

“The most obvious space is sponsor-led financing, PE buyouts, leveraged recaps and roll-ups which don't qualify as strategic acquisitions under RBI's definition. The second is structured deals where banks will take time to build comfort," he said.

“The third is the sub-Rs 500 crore segment where companies that don't meet bank eligibility but still need acquisition capital,” he added.

The new framework could also bring additional revenue opportunities for private funds.

JM Financial Asset Management’s alternative assets managing director Amit Dharod feels that the domestic private credit industry may actually benefit going ahead, as they can partner with Indian banks and participate in larger deals by structuring deal tranches.

Specifically, the RBI norms cap the consolidated post-acquisition debt-to-equity ratio at 3:1. Hence, any large control transaction that needs more leverage will require a subordinated, mezzanine, or preference tranche. In such a scenario, private credit funds will look to become the second-lien partner to bank senior debt. These deals typically come with larger ticket sizes and lower per-deal credit risk.

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